Supreme Court, U.S.
FILED
MAY 5 1993
OFFICE OF THE CLERK

92-1932

No. _____

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1992

RAY G. BESING and RAY G. BESING & ASSOCIATES, P.C.

Petitioners,

v.

LYN NOBLE HAWTHORNE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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May 5, 1993

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QUESTION PRESENTED

Whether a state court judgment based on sanctions disposing of Petitioners' claims without an evidentiary hearing constitutes a transfer of Petitioners' claims for reasonably equivalent value under 11 U.S.C. §548 as a matter of law.

PARTIES TO THE PROCEEDINGS

The parties to the proceedings are Ray G. Besing, a Dallas, Texas attorney; Ray G. Besing & Associates, P.C., a professional corporation for the practice of law in Dallas, Texas and Lyn Noble Hawthorne, an individual residing in the Conroe, Texas area.

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PETITION FOR WRIT OF CERTIORARI

Ray G. Besing & Associates, P.C. and Ray G. Besing, Individually, respectfully petition that a Writ of Certiorari be issued to review an opinion of the United States Court of Appeals for the Fifth Circuit.

OPINIONS BELOW AND GROUNDS FOR JURISDICTION

The opinion of the United States Court of Appeals for the Fifth Circuit dated February 4, 1993, is reprinted as Section A of the separate Appendix at pages A1-A11. The Judgment and Order of the United States District Court for the Northern District of Texas, Dallas Division, both dated and filed November 21, 1991, are reprinted as Section B of the separate Appendix at pages B1-B3. The Order of the United States Bankruptcy court for the Northern District of Texas allowing Respondent's claim and overruling Petitioners' Objection to claim dated February 21, 1991, and the Judgment of said Court dated the same date are reprinted as Section C of the separate Appendix at pages C1-C2. The Bankruptcy Court's Rulings ("Rulings") are reprinted as Section D of the separate Appendix at pages D1-D9.

The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

STATUTORY AND RULE PROVISIONS INVOLVED

The relevant sections of Title 11 U.S.C. and Title 28 U.S.C. are listed in the Table of Authorities.

STATEMENT OF THE CASE

Petitioners, an attorney and his professional corporation, are both Debtors in bankruptcy cases filed in the United States Bankruptcy Court for the Northern District of Texas, Dallas Division. The cases are being administered together. Respondent filed a proof of claim in the jointly administered cases relying on a state court judgment stemming from a determination of an alleged discovery abuse as a result of actions by the attorneys for the Petitioners in the state court action. (Sections F and G of the Appendix).

The individual Petitioner objected to the claim filed by Respondent on the ground that the affirmative state court judgment obtained by Respondent as well as the dismissal of Petitioner's state court claims and defenses through the striking of pleadings constituted a fraudulent transfer under Section 548 of the Bankruptcy Code ("Code"). (Appendix, Section E, pp. E1-E2).

The Bankruptcy Court held that no transfer as defined by the Code and envisioned by Section 548 of the Code had occurred. The Bankruptcy Court thus did not reach any of the other issues to be resolved in determining whether the state court judgment constituted a fraudulent transfer.

The United States District Court for the Northern District of Texas, Dallas Division, affirmed the Bankruptcy Court. A majority of the panel of the United States Court of Appeals for the Fifth Circuit ("the Court of Appeals") affirmed the decisions below but on a different ground. The Court of Appeals held that the state court judgment dismissing Petitioner's claims against Respondent was a transfer. The Court of Appeals, however, did not reverse the lower court but instead affirmed concluding that the state court's disposition of Petitioners' claims constituted a transfer for reasonably equivalent value as a matter of law. Thus

the Court of Appeals concluded that the judgment of the courts below should be affirmed because Petitioners could not, as a matter of law, prove a necessary element of their claim that the transfer was for less than reasonably equivalent value as required by Section 548 of the Code.

Petitioner's claims and defenses in the state court were dismissed for alleged discovery abuse. (Appendix, Section G). Such claims would have served to defeat or offset Respondent's state court claims later reduced to judgment which judgment is the only basis for Respondent's proof of claim. Petitioners' claims in the state court case which were eliminated by the striking of Petitioners' pleadings are reflected in the document entitled Plaintiffs' Second Amended Original Petition ("Petition"). (Appendix, Section H).

The Petition alleged claims against Respondent for specific performance of a settlement agreement or alternatively for damages and the recovery of properties, the total of which claims exceeded the claims made by Respondent for which she obtained a judgment without trial.

Although the Final Judgment upon which Respondent based her proof of claim purports to grant a summary judgment in favor of Respondent, the summary judgment related only to the relief sought by Respondent which would have been more than offset by the relief sought by Petitioner.

Moreover, close reading of the Final Judgment demonstrates that it is based on the Order of Sanctions with respect to alleged discovery abuse which is included as Exhibit G of the Appendix. In short, no true summary judgment procedure occurred as is evident on the face of the Final Judgment.

In any event, Petitioners contend that the State Court's Final Judgment does not determine as a matter of law that the transfer of Petitioners' claims effected by such Final Judgment was for reasonably equivalent value. Petitioners believe they are entitled to show that the transferred claims had value and that the state court judgment could be avoided thereby creating a valid and dispositive objection to Respondent's proof of claim.

REASONS FOR GRANTING THE WRIT

The Court of Appeals in affirming the courts below, specifically held, contrary to the courts below, that the state court judgment disposing of Petitioners' affirmative claims which would at a minimum constitute a complete set off and thus eliminate Respondent's claim filed in the bankruptcy court was a transfer as defined by 11 U.S.C. §101(54) (Appendix, Section I) for the purpose of finding that such state court judgment was a fraudulent transfer of Petitioners' assets pursuant to 11 U.S.C. §548. However, the Circuit Court determined that the judgments below should be affirmed because, as a matter of law, Petitioners could not show that they received less than a reasonably equivalent value in exchange for the transfer, an element necessary to avoid the transfer under 11 U.S.C. §548(a)(2)(A). In so doing the Court of Appeals ignored the fact that the Bankruptcy Court made no findings or conclusions on a material issue. Indeed, the Bankruptcy Court never considered any issues other than the question of whether a transfer occurred. (*Rulings,* Exhibit D to the Appendix). The Court of Appeals stated it could affirm the Bankruptcy Court's dismissal of Petitioner' Section 548 action because the record otherwise supported the decision.[1]

However, the record does not support the conclusion of the Court of Appeals. The record is replete with evidence of the value of the claims transferred involuntarily by Petitioners notwithstanding the Bankruptcy Court's abrupt ruling in the middle of the trial that no transfer had occurred as a matter of law. (See Exhibit H of the Appendix). The only aspect of the record relied upon by the Court of Appeals was the state court judgment. The Court of Appeals held that because a judgment based upon an alleged discovery abuse is a judgment on the merits under Texas law, that it could ignore the record of the

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[1] The Petitioners' action referred to by the Court of Appeals as a "§548 action" was procedurally an objection to Respondent's proof of claim and a counterclaim to Respondent's Complaint to Determine Dischargeability. The Dischargeability Complaint was dismissed without prejudice. See Sections C and D, pp. D5-D6 and C2 of the Appendix.

value of the lost claims and reach the erroneous tautological conclusion that because Petitioners lost, Petitioner's claims must have been without value.[2] Of course, this reasoning merely assumes the result and is without foundation. The Court of Appeal's ruling would of necessity mean that any time a Debtor lost a case for any reason that its claims asserted in such case had no value as a matter of law. This is not the law and should not be utilized to preclude Petitioners from challenging Respondent's proof of claim.

ARGUMENT

Although the Court of Appeals never specifically stated that it was applying either the doctrine of res judicata or the doctrine of collateral estoppel, the effect of its decision is to do so as a matter of law. The Court of Appeals states "the judgment conclusively established that the Debtors' claims against Hawthorne had no merit." *Matter of Besing*. (Appendix, Section A, pp. A9-A10). The Court of Appeals also stated that its decision was consonant with the Full Faith and Credit Act, 28 U.S.C. §1738 (Appendix, Section J) to give the state court judgment the same preclusive effect it would have in a Texas court. The problem with this approach is that nothing in the Bankruptcy code requires giving preclusive effect to state court judgments at all times. The Bankruptcy court is a court of equity which often "looks behind" state court judgments.

For example, in the area of dischargeability, bankruptcy courts look into the circumstances surrounding a state court judgment. *Matter of Allman*, 735 F.2d 863 (5th Cir. 1984), cert. denied 469 U.S. 1086 (1984); *Matter of Shuler*, 722 F.2d 1253 (5th Cir. 1984), cert. denied 469 U.S. 817 (1984). In *Matter of Shuler*, the court noted that a bankruptcy court *may* give collateral estoppel effect to subsidiary facts *actually litigated* and *necessarily decided* in a prior state court proceeding. 722 F.2d at 1256 (Emphasis added).

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[2] The concurring opinion notes the majority's tautology. *Matter of Besing* at n. 3, p. 2159 (Appendix A, p. A-11).

Moreover, state court judgments and procedures are not necessarily given preclusive effect in considering Section 548 claims. See *In Re Thrifty Dutchman, Inc.*, 97 B.R. 101 (Bankr. S.D. FLA. 1984); *Britt v. Damson*, 334 F.2d 896 (9th Cir. 1964), cert. denied 379 U.S. 966 (1965) (construing predecessor statute to Section 548). Preclusive effect must refer to the doctrines of res judicata and collateral estoppel. These doctrines cannot be applied without specific consideration of whether elements necessary for their application are present. Collateral estoppel (issue preclusion) requires that the identical issue must have been actually litigated in the state court suit. Because a default judgment or agreed judgment will not preclude issues by collateral estoppel, a judgment such as the one obtained by Respondent entered without actually litigating any claims but as a result of striking pleadings also should not invoke collateral estoppel. *Matter of Shuler, supra*; *In Re Thrifty Dutchman, Inc., supra*.

Res judicata (claim preclusion) can only apply if the first case was decided on the merits and involves the same cause of action sought to be barred in the second suit. Even if Texas law provides that a judgment based on alleged discovery abuse is a judgment on the merits, the judgment in the state court case here being considered did not decide the issues involved in this Section 548 claims objection. The question of whether the state court judgment constituted an avoidable fraudulent transfer was the issue below, and it is a decidedly different issue than the one decided by the state court. See *In Re Thrifty Dutchman, Inc., supra*, at p. 105.

Thus, the cases cited by the Court of Appeals to support its ruling are not controlling. The mere fact that state law gives preclusive effect to a judgment based on alleged discovery abuse does not require the bankruptcy court to do so when it is considering a claims objection based on the fraudulent transfer provisions of the Bankruptcy Code.

As the Court of Appeals noted in this case, state foreclosure sales conducted in accordance with state law are at best *presumed* to bring the reasonably equivalent value of the property. *Matter of Besing*. (Appendix A, p. A9 n. 14). The trustee is not

precluded as a matter of law from showing that the "totality of the circumstances" rebut the presumption. *In Re Grissom*, 955 F.2d 1440 (11th Cir. 1992). Some state foreclosure sales are judicial rather than non-judicial. Clearly neither res judicata nor collateral estoppel would preclude determining whether a judicial state foreclosure action constituted a fraudulent transfer.

Thus, the Court of Appeals has in this case carved out a special exception for state court judgments regardless of how obtained so long as the judgment is a determination on the merits under state law. No question of comity or deferring to state interests suggests that state court judgments of the type involved in this case are entitled to automatic preclusive effect while foreclosure judgments and others are not. See *In Re Thrifty Dutchman, Inc., supra.*

The Court of Appeals makes no analysis of the "totality of the circumstances" surrounding the state court judgment. That judgment show on its face that nothing was litigated and that Petitioners' claims and defenses were disposed of through sanctions including the most harsh sanction possible — the striking of pleadings. Thus, Petitioners and Respondent never truly joined issue and participated in an evidentiary hearing which could have resulted in Petitioners' obtaining affirmative relief or offset against Respondent's claim or defeating Respondent's claim.

If the "totality of the circumstances" should be examined, neither the Bankruptcy Court nor the Court of Appeals followed the correct procedure even if res judicata or collateral estoppel are applicable to these facts. The Bankruptcy Court, which rendered its opinion without a full presentation of the evidence stated that it did not address the applicability of either res judicata or cash collateral. (Section D of Appendix at page D3). Clearly the Court of Appeals applied those doctrines without addressing them.

Petitioners respectfully submit that determination of the applicability of res judicata or collateral estoppel with respect to a particular judgment requires a fact intensive analysis including an examination of the "totality of the circumstances" in the context of considering a Section 548 claim. The Court of Appeals

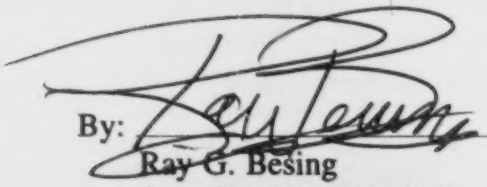
failed to make any analysis and its unsupported opinion that it was required to give preclusive effect to the state court judgment without an examination of the circumstances surrounding the award of the judgment to Respondent and without Petitioners being allowed to present a full record in the Bankruptcy Court should be reversed.

CONCLUSION

Neither the Bankruptcy Code, controlling law nor any policy consideration required the Court of Appeals to give preclusive effect to a state court judgment based on alleged discovery abuse when Petitioners assert that the state court judgment constituted a fraudulent transfer under Section 548 of the Bankruptcy Code for the purpose of objecting to Respondent's proof of claim. This court should grant this petition for Writ of Certiorari and reverse the decision of the Court of Appeals and direct a remand of this case to the Bankruptcy Court for trial.

Respectfully submitted,

LAW OFFICES OF RAY G. BESING, P.C.

By: 

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Dated: May 5, 1993